Irving Trust

RECEIVED JAN 31 1980

Financial Markets

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B 4750-1

Friday

Jan. 25, 1980

It was another bad week for the bond markets. No specific new developments accounted for the markets' early week decline; as the traders said, prices just wanted to go down under the accumulated weight of uncertainties about Iran, Afghanistan, inflation, and heavy supply calendars. The markets did try to come back at mid-week. A stronger than expected auction for the Treasury's $4 billion offering of two-year notes brought more than $8 billion in bids, with an average yield on the issue of 11.52%, 15-20 basis points lower than initial estimates. But the rebound came to an end following the President's State of the Union message, which intensified concerns over the international situation, and prices turned down again. Thursday's suggestion of reviving money growth added to the downward momentum, and the new note traded off about 1/2 point, to yield 11.80%. In the longer end of the government market, the 10 3/8% long bond traded at a record low price to yield 10.95%. The markets seemed to stabilize on Friday, despite the news of a 1.2% jump--a 14.4% annual rate--in the December consumer price index, but with little hope of near-term improvement.

The markets' mid-week breather was due in part to Federal Reserve actions in the open market. On Tuesday and again on Wednesday, the Fed carried out operations to supply reserves, a move that was viewed by some market participants as a shift toward slightly less monetary restraint. As it turned out, however, the actions were technical in nature. Float--the credit extended by the Fed to commercial banks during normal check processing--fell this week, while projections called for an increase. The authorities' injection of a sizable volume of reserves to the banking system was thus intended to maintain existing money market conditions, rather than to signify a shift in policy.

If anything, the behavior of the monetary aggregates may be giving the credit authorities reason to contemplate the need for further tightening. The latest weekly money figures showed gains of $1.0 billion in M_1 and $2.5 billion in M_2. As the Fed warns at the bottom of the weekly release on monetary aggregates, "special caution should be taken in interpreting week-to-week changes in money supply data." But the late 1979 monetary slowdown that Fed Chairman Paul Volcker --and more recently New York Fed President-designate Anthony Solomon--has cited as evidence of monetary restraint has become less convincing as the January figures come in.

Monetary policy has clearly been a primary focus of market attention in recent months. But the President's Budget message is sure to push fiscal policy into the limelight for a while. The President made it clear in this week's State of the Union Address that the pace of defense expenditures will be boosted in a move to bolster U.S. military strength. It will of course take a while to implement new expenditure plans. But it is likely that the next few years will see faster, not slower, growth in Federal outlays, which could generate faster economic expansion, reduce prospects for cutting the deficit, and release new inflationary pressures.

Glenn C. Picou

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Money Market Rates

	1/25/80 (noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors with highest credit rating	15.25%	15.25%	11.75%
Effective since	12/7/79		
Discount Rate at Federal Reserve Bank	12.00	12.00	9.50
Federal Funds	14.00	13.63	10.05
Repurchase Agreements	12.40	12.50	9.60
U.S. Treasury Issues - Yields			
Bills			
3 months	12.87	12.55	9.68
6 months	12.98	12.76	9.99
1 year	12.36	11.96	10.25
Coupons			
2 years	11.82	11.47	9.72
4 years	11.04	10.72	9.10
7 years	11.05	10.75	8.97
10 years	11.09	10.78	8.95
Long Bond	10.96	10.54	8.85
Negotiable Certificates of Deposit-Secondary Market			
1 month	13.50	13.30	9.85
3 months	13.55	13.45	10.25
6 months	13.75	13.45	10.70
1 year	13.25	12.75	10.75
Bankers' Acceptances			
1 month	13.30	13.35	9.88
3 months	13.60	13.55	10.20
6 months	13.85	13.55	10.75
Eurodollar Deposits			
1 month	14.25	14.06	10.31
2 months	14.44	14.13	10.50
3 months	14.63	14.13	10.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	12.50	12.88	6.00
1 month	13.00	13.00	9.63
3 months	12.00	11.75	9.63
Bank Holding Companies			
1 month	13.05	13.00	9.88
Dealer Placed:			
3 months	13.15	12.88	10.25
New Aa Corporate Utility Bond	12.40	12.05	9.50
Tax Exempt			
6 month Project Notes	5.85	5.65	5.25
12 month Project Notes	N/A	N/A	5.40
20 year AAA Bond	7.00	7.00	5.80

This information represents prevailing market yields. It should not be construed as an offering. All yields are on the offered side of the market.

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